

Agenda Packet for January 28, 2010

Agenda January 28, 2010

Actions January 7, 2010

“City of San Diego’s Fiscal Outlook” by the Citizens’ Fiscal Sustainability Task Force

Peer Review:

- Bob Nelson
- Erik Bruvold
- Steven P. Erie, Vladimir Kogan, Scott A MacKenzie

Parking Lot January 7, 2010

Memorandum from Andrea Tevlin, Independent Budget Analyst

Memorandum from Bob Nelson, Chair

CITIZENS' REVENUE REVIEW AND ECONOMIC COMPETITIVENESS COMMISSION

Bob Nelson, Chair

**AGENDA FOR
THURSDAY JANUARY 28, 2010, AT 5:30 P.M.**

**COUNCIL COMMITTEE ROOM (12TH FLOOR),
CITY ADMINISTRATION BUILDING
202 C STREET, SAN DIEGO, CALIFORNIA**

For information, contact Breanna Zwart, Council District Four
202 C Street, 3rd Floor, San Diego, CA 92101
Email: bzwart@sandiego.gov
619-236-7180

NON-AGENDA PUBLIC COMMENT

COMMISSIONER COMMENT

CITY ATTORNEY, IBA, AND CITY AUDITOR COMMENT

ADOPTION AGENDA

Approval of the Record of Action Items for January 7, 2010

INFORMATION/DISCUSSION ITEMS

- ITEM-1: Report from the Citizen's Fiscal Sustainability Task Force: Status
- ITEM-2 Update on the City Services Survey from the Independent Budget Analyst
- ITEM-3 Commission discussion on Revenue Review
- ITEM-4 Commission discussion on outside venues

UPDATES

- ITEM-5 Revenue Audit
- ITEM-6 Economic Competitiveness
- ITEM-7 Peer Review
- ITEM-8 Commission Administration

Bob Nelson
Chair

**CITIZENS' REVENUE REVIEW AND ECONOMIC COMPETITIVENESS
COMMISSION**

Bob Nelson, Chair

**ACTION FOR
THURSDAY JANUARY 7, 2010, AT 4:00 P.M.**

**CONFERENCE ROOM A (12TH FLOOR),
CITY ADMINISTRATION BUILDING
202 C STREET, SAN DIEGO, CALIFORNIA**

For information, contact Breanna Zwart, Council District Four
202 C Street, 3rd Floor, San Diego, CA 92101
Email: bzwart@sanidiego.gov
619-236-7180

NON-AGENDA PUBLIC COMMENT

Lorena Gonzalez commented on the need for jobs for local workers.

COMMISSION COMMENT

Chair Nelson discussed the creation of a Peer Review Panel.

COUNCILMEMBER, CITY ATTORNEY, IBA, AND MAYORAL STAFF COMMENT:
None.

ADOPTION AGENDA

Approval of the Record of Action Items for December 15, 2009

ACTION: Motion by Mr. Singh, second by Mr. Morton, to approve.

VOTE: 6-0; Nelson-yea, Moser-yea, Morton-yea, Barros-yea, Bonanno-
not present, Gin-not present, Standifird-yea, Singh-yea

DISCUSSION ITEMS

ITEM-1: Goals of the Commission

ACTION: No action taken. Discussion only.

ACTION ITEMS

ITEM-2 Appointment of Vice Chair

ACTION Motion by Mr. Morton, second by Mr. Singh for Roque
Barros to serve Vice Chair

Vote 6-0; Nelson-yea, Moser-yea, Morton-yea, Barros-yea,
Bonanno-not present, Gin-not present, Standifird-yea,
Singh-yea

ITEM-3 Appointment of Parliamentarian

ACTION Motion by Mr. Morton, second by Mr. Barros for Ted
Bonanno to serve as Parliamentarian.

Vote 6-0; Nelson-yea, Moser-yea, Morton-yea, Barros-yea,
Bonanno-not present, Gin-not present, Standifird-yea,
Singh-yea

ITEM-4 Approval of Commission Calendar

ACTION No action taken. Item will return to Commission for further
discussion.

ITEM-5 Commission Work Schedule

ACTION No action taken. Item will return to Commission for further
discussion.

Bob Nelson
Chair

City of San Diego's Fiscal Outlook

Citizens' Task Force Report Highlighting Challenges & Opportunities

December 11, 2009

Submitted by the members of the
Citizens' Fiscal Sustainability Task
Force

Vincent Mudd, Chairman

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Preface

The City's projected fiscal forecast for FY2011 shows a deficit of \$179M. This assumes the FY2010 budget ends the year balanced. On November 17, 2009, the Financial Management Department issued the Fiscal Year 2010 First Quarter Budget Monitoring Report, which presents projections of year-end revenues and expenditures, based on actual data for the first three months of the fiscal year (through September 30, 2009), the net projected budgetary deficit is \$7.5 million for FY 2010. If this trend continues, FY2010 could end with an unanticipated revenue shortfall.

In addition to the First Quarter Budget Monitoring Report, the County of San Diego reports that sales tax and property tax revenues are down for the entire County. While this is consistent with the City of San Diego's revised revenues forecast, it confirms the weakness in the current local economic conditions and the fiscal uncertainty the City now faces. We believe that the principles contained herein are imperative to the long term viability of the City. The announcement of further budget deficit growth that was reported on November 17th simply serves to underscore the state of emergency the City now faces. This only makes the suggestions contained in this task force report - to eliminate the structural deficit sooner, versus later - more imperative.

Introduction

This is a report on the Fiscal Outlook of the City of San Diego compiled by a special citizen's task force. Established as part of the Civic Leadership team, this task force is comprised of business leaders and professionals with expertise in the management of large and small organizations, municipal government, non-profits and educational institutions¹. All of the opinions and recommendations contained herein are those of the independent members of the committee.

This committee met weekly over a five-month period to study the overall status of the City's fiscal position. The task force reviewed relevant City of San Diego data and records², as well as similar data from other comparable municipalities. The task force interviewed members of the City's executive staff (including Jay Goldstone and his fiscal team). Also interviewed were the City's Independent Auditor and the Independent Budget Analyst - Andrea Tevlin - with her analyst team. The task force met with representatives from the County of San Diego, various local constituents, including organized labor, non-profits, private business and citizens groups, and various subject matter experts with expertise that covered trash, IT, public benefits, and municipal bankruptcy.

¹ Task force member bios can be referenced under "Task Force Member Bios" at the back of this document.

² Documents reviewed by task force members during the creation of this report can be referenced under "Source Materials".

Executive Summary

Our report takes into consideration the current financial status of the City of San Diego, the City's past financial history, and makes suggestions moving forward. Our approach is based on a set of guiding core principles that are intended to be used as a moral compass to not only resolve our current financial crisis, but to guide the City in making fiscally sound decisions in the future. Beyond core principles, we highlight a recommended course of action that is intended to immediately produce results in the form of budget savings. The task force recognizes that it will take a balance of cost cutting and revenue generating methods to achieve optimal stability. Everything must be on the table and no reasonable idea should be dismissed before it is fully vetted. Timing is everything. The timing for the implementation of any presented recommendation will have considerable impact on whether results can help right now, in the FY2011 budget, or in future budget years.

The City has been "living beyond its means" for a number of years; this has been accomplished in several ways, including:

- use of permissible accounting deferrals that do not recognize the true cost of long term commitments, such as retiree medical benefits promised to city employees
- underfunding of reserve accounts and deferring expenses to subsequent years, disguising the problems and moving their resolution to a future time
- underfunding the employee pension plan(s), causing a significant fiscal crisis for the city

This structural imbalance has become unmanageable and can only be addressed in four ways:

- Cost Cuts - significant reductions in City services to its residents, resulting in sizable City employee layoffs and deterioration in citizen quality of life
- Efficiency - delivery of City services in a more cost effective manner, including where appropriate, the use of private contractors, automation, outsourcing, and alternative methods of service delivery; City voters have mandated that the City make use of Managed Competition for the provision of services but the City has not implemented this practice
- Change in Scope - It is time for the City to fully assess the full offering of services it offers and discontinue those that are not core services
- Revenue Increases - increases in City fees and taxes on residents; however, the majority of meaningful increases in income cannot be accomplished without a citizen vote (unless the increase is for an enterprise fund) which means that new sources of income may not be available to the City general fund in the short term.

It is time for City leadership to step up and permanently address the chronic budget shortfall with structural changes in the way that the City conducts its fiscal business. Failure to do this now will result in the continued deterioration of the City's financial condition, as well as a reduction in the quality of life for its citizens. If the budget shortfall is not addressed quickly, it could lead to the City's inability to continue to provide the services the citizens have come to enjoy.

The task force calls on the Mayor and City Council to take the steps necessary to return the city to a sound financial position. If City leaders do not take action to resolve this situation, they will jeopardize the City's fiscal stability and our claim to being "America's Finest City". At this time, every idea should be out on the table for consideration. The solution must be about fiscal balance. In the end, the task force concluded that a major structural deficit exists. No more "business as usual" for the City of San Diego - serious change is required.

The City's Current Fiscal Status

The City of San Diego's current fiscal outlook is very dire; Mayor Sanders disclosed (Fiscal Year 2011-2015 Five-Year Financial Outlook; September 30, 2009) that, absent meaningful actions taken at this time, current projections indicate an unprecedented shortfall in the FY2011 General Fund operating budget of ~\$179Million, which is nearly 17% of general fund revenue.

	FY2011	FY2012	FY2013	FY2014	FY2015
General Fund Revenues:	\$ 1,061.6M	\$ 1,094.1M	\$ 1,125.4M	\$ 1,156.8M	\$1,196.6M
General Fund Expenses:	\$ 1,240.7M	\$ 1,253.3M	\$ 1,284.3M	\$ 1,328.9M	\$1,343.0M
Projected Shortfall:	\$ (179.1M)	\$ (159.1M)	\$ (158.9M)	\$ (172.1M)	\$ (145.4M)

Andrea Tevlin, City Council's Independent Budget Analyst, has reviewed these projections and concurs that the basis and assumptions for deriving these projections were sound; in fact, she states that these projections may be optimistic and do not fully take into account certain items that could make the actual results worse. The IBA forecasts a potential worst-case scenario that may result in a FY2011 shortfall *as large as \$230 million*.

It is reasonable to predict that once the mid-year actual revenue results come in, the City will need to adjust its revenue forecasts since revenues will probably be down substantially.

There is no dispute that the budget shortfall is severe and will not correct itself without major fiscal changes that are structural³ in nature and are designed to provide long-term solutions.

We must discontinue the process of using fund transfers, deferral of current year expenditures or underfunding obligations for future benefits that simply result in the moving of current year expenditures to the following year or years. The City must not delay developing a permanent solution to what seems to be a chronic budget deficit cycle. We strongly recommend against any more interim one time fixes that are predicated on the assumption that the future will be better than the present and merely take today's problems and make them bigger problems tomorrow.

³ Throughout this report, we will refer to Structural changes or fixes. "Structural deficit" is used as defined by lexicon as "A budget deficit that results from a fundamental imbalance in a government receipts and expenditures, as opposed to one based on one-off or short-term factors."

The City's Fiscal History

- The City has been “living beyond its means” for a number of years, deferring important expenses and postponing or underfunding a number of obligations that must now be addressed (such as aging infrastructure, underfunded retirement plans, and unfunded retiree medical benefits).
 - *The fact that some City officials believed “that temporary revenue or expenditure shifting or inappropriate reserve depletion is necessary given the current tough times and we will make it up when economic times are better” has damaged the City in the past. Hope can never be a strategy.*
 - *The fact that City officials chose to push out these costs to future year’s taxpayers has finally caught up with the City.*
- The City has granted employee benefits, including generous pension programs and retiree medical benefits, which have grown to an unsustainable level and have been severely underfunded.
 - *The fact that these benefits were basically unaffordable was masked for several years by overt accounting manipulations, namely not funding the full annual required contributions to the pension fund and not funding any of the actuarially computed cost for retiree health benefits (other than the “pay-as-you-go” cash expenses of existing retirees)*
 - *The costs, while not being recognized by the City in its annual budget, have continued to grow at a compounded rate with interest.*
 - *For example, in 1994 the City’s budget for pension expense was 6% of payroll cost. Today, 15 years later, the cost is now 28% of payroll (and growing) for pensions.*
 - *To be clear, this is not solely an indictment of organized labor, many constituencies participated in creating this problem, i.e., previous political leadership, including previous Mayors and council members, previous city management and previous Pension Board members. Everyone participated and everyone profited by allowing this issue to spiral out of control. There is no moral high ground that can be claimed by either side.*
- While the City has taken a number of steps to provide City services in the most efficient and cost-effective manner possible through the use of Business Process Re-engineering, it has not implemented its most powerful tool, Managed Competition. In November 2006, under Proposition C the voters mandated Managed Competition, which could yield more efficiencies and lower cost. To date the City has simply not implemented the Managed Competition mandated by the vote of the people.
- The current economic recession has been deeper and may last longer than originally forecast. This has impacted nearly every taxpayer in the City and has severely impacted revenues that the City depends on. City revenues are down \$67 million from their fiscal year 2008 highs and the City needs to cut expenses to keep pace. . In fact recent revenue trend continue to move downward.
- The City raises the least General Fund Revenues per household, measured as a percentage of household income, of any of the ten largest cities in California.

- The City provides some services selectively to certain residents with no cost recovery to the General Fund while charging other residents and businesses for the same service. Examples include:

- Residential Trash Collection
- Storm Water Compliance

Core Principles

It is reasonable to assume that there will be considerable differences of opinion among citizens and political decision makers on how to deal with the current budget imbalance. In light of this, the task force has established a set of 'Core Principles' to be used as a guide in the inevitable discussions and debates.

1. *Institute Sound Fiscal Management Practices*

The City must live within its means. This necessitates a comprehensive budgeting process which accounts for all costs being incurred during the budget year, both out-of-pocket cash costs as well as properly funding reserves for costs of benefits being accrued and earned currently but to be paid in future years, including maintenance costs for current wear and tear usage which will have to be paid in future years, as well as for statistically derived necessary reserves for "self insured" liability exposures such as workers compensation, ADA compliance, and City legal liability claims.

2. *Without a mandate from the voters to the contrary, the City must only provide the 'Core Services' that it can afford*

The City should identify those essential services required by law or charter and fund only those services that existing revenues can support.

- State law and the City charter delineate those services that the City must provide (i.e. police department, fire department, water utility, public works services, water services, building inspection services, public health services, park and recreation services, library services and such other services as maybe desired and authorized by Council by ordinance).
- Unfunded state and federal mandates must also be provided for (i.e. storm water, waste water, clean water, ADA and State requirements to provide trash collection, OSHA, etc.)

3. *The City must not use onetime deferrals to solve structural budget imbalances.*

4. *The City is a service provider; not an employment agency*

Its purpose is to provide essential services to its citizens. It is not the purpose of the city to provide direct employment opportunities to its citizens but rather to employ people where the private sector is unable to efficiently and effectively, in a competitive arena, provide such services that the City Charter requires and/or the City chooses to provide its citizens.

5. *The City should practice high quality "Cost-Efficient" Business Management*

Except for those services that cannot be outsourced by law, the City should provide all other services using the most cost-effective means, whether this be by utilizing city employees, contractors, suppliers, or outside service providers. The public has been very clear that Managed Competition is a process that they want implemented so the public can receive the appropriate level of services at the lowest cost. The City should utilize alternative approaches to improving the efficiency and effectiveness of its operations; including automation, Managed Competition, and outsourcing. Due to labor contract provisions, such as generous pension plans, retiree medical benefits, etc. the fully-loaded City employee unit cost is very high; therefore it is critical that the City act to address these high unit costs immediately.

6. *Enterprise Funds must be scrutinized*

- Eliminate those funds that could be privatized and converted to revenue without expense or liability to the City, (i.e. IT, golf courses, airports), so that the City can focus on its core mission.
- Set up new funds that will require services provided to be self-funded (i.e. storm water compliance, trash, landfill management); not funded out of the General Fund.

7. *General Tax and Fee Increases should be considered only as a last resort*

As a general principle, general tax and fees should be set as low as possible while at the same time be sufficient to pay for the services needed to provide for an acceptable level of service to the public. The City does have a responsibility to attract and retain businesses in San Diego while providing a superior environment for its citizens to live and work; however its tax and fee policy should not be so high as to drive businesses or citizens out of the City of San Diego.

Quality of life is always an appropriate consideration for future generations and our ability to attract new businesses and citizens to "America's Finest City". Said differently, we realize we can't save our way to prosperity. Nevertheless, any tax should be set as low as possible while at the same time be sufficient to pay for the services needed to provide for an acceptable or even desired level of service to the public.

8. *The City must avoid raiding reserve accounts or rainy day funds unless there is a declared public safety emergency*

The concept of reserve funding is to protect the City against future substantive risk. Reserve funding is a "best-practice" and should never be considered a slush fund to balance year-end shortfalls. Extraordinary use of reserves should require a high profile action (like the declaration of an emergency by the Mayor and City Council) so the public is aware they are being used and then only as an absolute last resort.

Task Force Observations

- The exclusion of the full actuarial cost of City-paid Retiree Health benefits in the financial forecast is unacceptable; the City must either:
 - Fully fund not only the pay-as-you-go costs for existing retirees but also the total actuarially accrued cost being currently incurred for existing employees (and the cost of the past service liability for employees' prior years of service) which has never been expensed or funded, or,
 - The City must explicitly announce to its employees that they no longer will have unlimited retiree health benefits. The City must also reduce the benefits to a level the budget can sustain, OR eliminate the benefit. The City cannot have it both ways (i.e. not accruing for the expense of current employee retiree health benefits because those benefits are not "vested benefits" while at the same time continuing to provide this benefit for employees).
- The task force concluded that even though the number of City employees seems in line with comparable cities, the City's unit cost of labor is extremely high.
 - The cost of benefits, particularly pension and retiree health, is substantially higher than benefits provided in the private sector.
 - These benefit costs are a principle cause of the City's financial crisis; such costs are simply unaffordable given the City's current revenue structure. We believe that these costs are excessive and are also unjustifiable in the current market environment.
 - It is noted that this situation is not unique to San Diego; many other municipalities in California are facing budget crises due to this same issue: unaffordable employee costs. The city of Vallejo is already in bankruptcy due primarily to this issue.
 - Municipalities have repeatedly ratcheted up their labor costs to the highest comparable city wage scale, independent of the broader private sector labor market rates.
- The task force took note of inherent obstacles to efficiency in municipal operations.
 - Unlike in the private sector, there is no "bottom line" metric with which to evaluate performance and efficiency
 - In the private sector an operating entity must earn a profit on its invested capital or it simply ceases to exist. This built-in discipline is inherently absent in government operations.
 - Civil Service rules hinder personnel changes that would otherwise be made if "at will" employment rules similar to those used in the private sector were in place.

The net result is that it is exceedingly difficult in practice to discharge a poorly performing employee. The consequence is reduced morale and a further increase in the cost of City operations. While the vast majority of City employees are competent, diligent workers, the forced toleration of underperforming employees is a serious morale problem, which over time impacts overall efficiency.
- The task force also concluded that the taxpayers have shown no real interest in increasing their tax burden to pay for the very high costs of City worker benefits. The City should not be in the business of assuring high value employment. Rather, the City should focus on delivering core services to the taxpayers at the best value possible.

Recommended Course of Action

1. The Mayor and Council must have the political will to declare a Fiscal State of Emergency and immediately eliminate the Structural Deficit.
2. Immediately eliminate the current 800 vacant positions from the budget. The presence of these vacant positions, while allowing for some operational flexibility, is problematic and could serve as a departmental expense "slush fund".
3. The City must immediately reduce, at a minimum, the quantity and/or quality of services that it provides to its citizens in order to eliminate sufficient cost to equal the \$179 million deficit in the 2011 budget.
4. The City must find a way to reduce its unit cost of labor to affordable levels more comparable to that in the private sector. It is unacceptable and unsustainable for citizens to have to reduce service levels to finance an excessive City worker benefit structure. This will take aggressive and innovative action.
5. The City must immediately implement the voter-approved Managed Competition Ordinance and begin to deliver services in a competitive and cost-effective manner either by City workers or by the private sector. This is a structural change already mandated by the voters and must be pursued with diligence and urgency.
6. The City should amend the Charter to significantly reduce or eliminate the number of classified positions; therefore giving the City a more flexible workforce.
7. The City should formally adopt the concept of a rolling multi-year budget cycle in order to eliminate the deceptive practice of pushing current year liabilities into the next year as a way to avoid properly resolving the chronic annual shortfalls.
8. The City should adopt the concept of a 'Poison Pill'⁴ to enforce a new fiscal management process. This will require a pre-approved formula for meeting future revenue shortfalls should the Mayor and City Counsel be unable to structurally solve the problem using normal procedures.
9. The City should immediately implement a plan to promote business expansion and growth in the City of San Diego. We compete with other cities for business expansion and must not lose our focus. The continued loss of business-related revenue will deal a major blow to the City's economic prospects. Importantly, superior fiscal management of the City's resources will go a long way to improving our ability to attract new businesses and the attendant taxpaying employees.
10. The City should establish a fact-based dialogue with citizens from all walks of life to establish a common vision of what services voters want and how much are they willing to pay for them.

⁴Poison Pill - See NY example

Institute a plan that is immediately implemented in the event of multi-quarter deficits. The plan would automatically include an across the board cut of services plus an automatic fee hike. No one would be spared and no one will be happy however this should motivate Council and the Mayor to manage and operate the City in a way that guarantees real-time fiscal stability. Details of this plan would have to be developed with input from the public and a Charter amendment would be required.

11. If the City Council is unable to make the required structural cuts that will balance the FY2011 budget without accounting deferrals and gimmicks, a "Citizen's Initiative" should be placed on the ballot that forces a permanent reduction of City staff by at least 1,500 people – which should yield a structural reduction of more than \$100 million once other long-term liabilities are included.
12. Once permanent fiscal disciplines have been implemented and exhausted, the City should seek voter approval to create new fees and/or taxes to support delivery of the remaining services that the citizens deem to be essential core services; for example Storm Water Compliance and Trash Collection.

Failing all of the above, a structural deficit would still exist and continue to put undo fiscal strain on the City; absent any other alternatives the City would be forced to consider seeking injunctive relief by filing for Chapter 9 Bankruptcy protection to allow the City to put its long-term fiscal house in order. Although the task force feels that in this uncertain national financial climate, all options should be on the table, at no time in our discussions with the city has the city recommended bankruptcy as an option.

The task force believes that a combination of items 1-12 will solve the budget deficit without having to seek bankruptcy protection. The voter initiative provides a powerful incentive for City leaders to make hard and difficult choices now – otherwise the public will make the choices for them.

Many solutions, however interesting, may not be possible to implement in time to actually impact the FY2011 budget. Therefore a clear understanding of the impact of timing on any proposed solution is critical when debating real solutions. The City must be mindful that the timing of any suggested actions can bear great significance on positive or negative fiscal results. As an example, if a revenue solution was preferred, it is important to understand that the timeline for any voter-approved revenue increase may not be viable until at least November 2010, too late to help the FY2011 budget shortfall. Another example might be the unwinding of past pension benefits. The fact is that the City has considered ways to legally reduce the excessive pension benefits over the past 36 months with little success. Although we do not want the city to stop pursuing its legal remedies, (which may have to eventually become a statewide constitutional challenge to the concept of vested benefits for municipal employees), we understand that even if successful, the extensive process to unravel these benefits or the constitutional challenge to vested pensions may not be realized for many years to come in light of potential extensive court appeals. Therefore this solution cannot be relied upon to resolve the FY2011 budget shortfall. The issue of timing will also apply if a bankruptcy option were to be considered. Declaring bankruptcy on a City the size of San Diego is not an overnight process or solution.

It is therefore very important to compel anyone that engages in the process of looking for structural reform in the City's budget to provide a clear answer as to the timing of their proposed solutions in order to be considered credible. Offering a solution that may take years to implement is a long-term solution, but it does not address the FY2011 budget shortfall. It is critical that we find real structural solutions to the FY2011 projected shortfall that does not negatively impact the FY2012 budget year.

Potential suggestions from others that do not address the structural issues

	<u>FY2011</u>	<u>FY2012</u>
Projected Budget Deficit (as of 10/09)	\$(179 Million)	\$(159 Million) carry forward from FY2011
<u>One-time transfers</u>		
<u>Delay</u> by 12 months the reserving of ADA	\$5 Million	\$(5 Million)
<u>Delay</u> by 12 months the reserving of Workers Compensation	\$5 Million	\$(5 Million)
<u>Delay</u> by 12 months the reserving of Legal Liability Fund	\$6 Million	\$(6 Million)
<u>Continue</u> Pay-As-You-Go for retiree health benefits at base level	\$20 Million	\$(20 Million)
<u>Raid</u> entire City Reserve Fund Balance for one year	\$80 Million	\$(80 Million)
<u>Extend</u> \$32 million McGuigan Lawsuit payment to 5 years vs two years	\$25 Million	\$(7 Million)
<u>Delay</u> one-time expenses and shift into 2012 budget year	<u>\$15 Million</u>	\$(15 Million)
New Deficit Total before additional budget cuts/transfers	<u>\$(23 Million)</u>	<u>\$(23 Million)</u>
Beginning FY2012 projected deficit (PLUS additional OPEB growth)		<u>\$(320 Million)⁵</u>

As you can see, there are a number of short-term tactics that would historically be used which appear to reduce the budget shortfall for FY2011 without making structural cuts in personnel or services. However, this only postpones and exacerbates the problem. We have seen the State of California practice this sort of short-sighted budgeting in the past. An informed public knows that this tactic does not resolve the basic budget imbalance.

Leadership requires making difficult decisions. Practicing good fiscal leadership involves protecting the financial viability of the City of San Diego by making good decisions based on best practices. Once and for all, we must face up to the imbalance that has been created by our past refusal to address these issues. We have been here before. Allowing for one-time transfers is disingenuous and destructive since this only makes the FY2012 budget shortfall even worse. We must implement solutions that actually repair and balance the FY2011 budget while doing no damage to the FY2012 budget.

The task force strongly believes that any attempt to simply use fund transfers only serves to remind the public that the City leaders have chosen to ignore the painful lessons of the past rather than exercise the political will and discipline to face up to our challenges; fund transfers do not work forever. Further, any attempt to utilize inappropriate one-time fixes in lieu of structural changes in balancing the budget must not violate conditions of the City's requirements with any and all regulatory authorities.

⁵ This presumes the funding deferred in FY2011 is made in FY2012 through a catch up adjustment.

Conclusion

It is time for the concept of "sacred cows" and "impossibilities" to be put out to pasture. If we are to achieve true structural reform, everything must be put on the table to be debated openly, passionately and with honesty. In the past, too many ideas have been prematurely dismissed by people that believe that they alone recognize the right answers. A well informed public will make the right decisions.

Any option under consideration must take into deliberation whether the solution requires voter approval, charter change, council approval, judicial approval or legal adjudication. Each of these processes will impact the timing and implementation of each solution.

The Task Force applauds the City for taking decisive action on the FY2011 \$179 million dollar deficit; however, it used short-term deferrals like account shifting or reserve funding delays as part of its solutions and we do not support this. The sooner the deficit is resolved, the lower the shortfall for FY2011 and beyond will be. Action initiated now will result in less drastic cuts going forward. Since more than modest revenue increases cannot be realized prior to a public vote in November 2010, the budget must be balanced primarily with structural cuts in services. If the City cannot balance the General Fund operations budget while continuing to honor all past obligations by January 2010, a "Citizen's Initiative" should be placed on the November 2010 ballot that will specifically call for permanent cuts in City staffing.

The City has to change the way it does business. We must stop the half truths, unfunded mandates and budgetary gimmicks. We can no longer promise what we cannot afford. The task force herein recommends several near term solutions, but we must stay focused on the bigger problem -- the practice of making promises that we do not properly fund or have the resources to pay for -- or history will likely repeat itself. Once the budget is brought into structural balance we must continue to be vigilant in our stewardship of the quality of life. We do not propose only cuts in services as saving our way to prosperity. We must determine what quality of life citizens require and are willing to pay for.

We are asking our elected officials to show the political will to make the difficult decisions to permanently address the deficit once and for all with true structural reform. The time to act is now if we wish to preserve our claim as "America's Finest City".

Additional Information from the Task Force

The task force had a number of in-depth sessions where we discussed the structure of the City's fiscal problems. We used these sessions to brainstorm ideas from cost cutting and revenue increases to looking at the entire Civil Service structure and its impact on the way the City operates today and how it might act differently in the future. To follow are excerpts from these various brainstorming sessions.

Development Impact Fees

One of the more difficult questions that we were unable to resolve dealt with Development Impact Fees. Further extensive study of these fees is required.

1. How much has the City collected?
2. How long are the fees held?
3. If the project for which the fee was collected never eventuates when does the fee get returned and to whom is the fee returned?
4. How can the fees be used for projects that the fee was never collected to fund?

Cost Cutting Suggestions

1. Consider the sale of under-utilized city real estate assets. This would not be new revenue since it involves the sale of an asset. However the revenue received could be used to retire other capital debt/bond obligations which will relieve the General Fund of on-going expenditures.
2. With regard to employee benefits, the following issues should be aggressively investigated where existing state law allows or is eventually modified to allow changes in vested benefits:
 - The City Charter calls for the cost of a normal pension to be shared 50 -50 between the City and the individual employee.
 - *The City should immediately (through Meet and Confer) stop paying any City "pick up" of the employee's 50 % that still remains from prior labor negotiations.*
 - The City, as the Plan Sponsor, should aggressively challenge with the Plan Administrator (SDCERS) the underlying logic and the computation of the current 50 - 50 calculation.
 - *In 2002 the employees paid 10% of their salary while the City also paid 10%. But in 2009, the employee pays 10% while the City pays 30%.*
 - *Does normal cost include the 13th check? The COLA? If these are not part of "the cost of a normal pension to be 50 -50 shared" then are these truly vested benefits? Or can they, like retiree health, be eliminated?*
 - *Disability accounts for \$319 million of the current \$3.3 billion pension benefit liability. Disability benefits are not considered to be part of the normal pension cost that is shared 50 -50 between the City and the individual employee.*
 - *If disability is in fact different, then can it be eliminated as not being a vested benefit the same as retiree health?*
 - The City should aggressively preclude employees from simultaneous "double dipping" in both workers compensation and disability pension payments.
 - *The employees should be required to choose one or the other; a disability pension or a service pension.*

- *The City should aggressively monitor all people receiving disability benefits to ascertain whether their disability continues or whether they are in fact gainfully employed elsewhere. Such periodic confirmation efforts appear to be required by Muni code section 24.0407 but apparently are not being pursued.*
- *Disability administration is an excellent candidate for outsourcing as it has become an area requiring considerable experience and expertise, especially in times of economic stress for workers.*

Revenue Generating Suggestions once structural fiscal discipline is restored

The City of San Diego raises the least General Revenues per household, as percentage of household income, of any of the ten largest cities in California. Therefore it may be reasonable that once the City has implemented long-term fiscal policies that do not create future deficits and successfully restores the trust of the Voters, and a shortfall remains; the City may look to the voters to approve new revenue.

Below are a few potential sources of new revenue for the City. By listing the items, the task force is not specifically endorsing the revenue concept or expressing any preference.

1. The following potential revenue generation sources should be looked into:

- Transient Occupancy Tax (TOT)
- Storm Water Compliance fees
- Real estate transfer tax
- Business license fee
- Refuse collection fee
- Utility users' taxes
- Parking meters
- Fire protection zones

In addition to new revenue, it is possible that the City may be providing services that the private sector can provide without the employment of City workers. Therefore the public can still receive the benefit of the service and the city can be relieved of the operations liability, expense and long-term future pension/retiree health expense.

1. Privatize the City's golf courses and receive new General Fund revenue
2. Outsource the operation of Brown Field and Montgomery to the Airport Authority and receive new General Fund revenue.
3. Outsource landfill management and receive new General Fund Revenue.
4. Evaluate other services that a city with a smaller workforce will be unable to provide internally yet can be provided by other public agencies or the private sector.
5. Non-core services that are currently being provided without a self-sustaining revenue source should immediately be eliminated as a future City obligation.

Closing Comments

It is important to note that since FY2005, the City has made significant progress in addressing many of its financial challenges. In 2008, The City approved a new pension system for employees hired on or after July 1, 2009 that will in fact lower overall future pension cost. In addition effective February 2007, new hires no longer have the ability to purchase service credits, have access to the Drop Program, and no longer have a retiree medical plan paid for by taxpayers. In 2009 the City also enforced 6% wage concessions on the majority of city workers that would cover FY2010 and FY2011, thus lowering expenses for 2 fiscal years. Still, we are facing a minimum projected \$179 million dollar deficit for FY2011. The majority of this represents a structural deficit whereby without permanent change we will have to deal with this shortfall each year.

There have been a number of solid accomplishments by the Mayor and the Council that, in part, are returning the City to a more stable footing. The truth is that many of the recent fiscal changes will create savings in the future. By all accounts, the City employs a capable workforce of people who seem to be working in the best interest of our citizens. We are, however, still paying for past mistakes. Any real long-term remedy is going to be very difficult but necessary to resolve our fiscal imbalance between current revenues and cost of services.

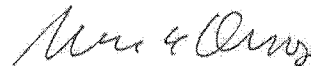
Current workers did not create the problems we are facing, yet they are going to be greatly impacted by any sustainable solutions to the City's chronic budget deficit. Simply stated, major cuts in personnel, benefits, and services, as well as increases in revenue are, in our judgment, unavoidable. The City must develop a plan that eliminates the FY2011 deficit with structural changes, not one-time fixes.




Vincent Mudd
Chairman



Bill Roper
Vice-Chairman



Neil Derrough



Pete Garcia



Mark Koob



Dan Shea



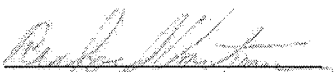
Susan Snow



Mark Stephens



Robert Tjosvold



Richard Vortmann



Barbara Warden

Source Materials

1. Fiscal Year 2011-2015 Five-Year Financial Outlook; September 30, 2009
2. IBA Report #: 09-75
3. Personnel Expense Analysis
4. Per Capita Income Comparison
5. City Revenue Comparisons
6. "The Bottom Line" report, (prepared by the Center on Policy Initiatives)
7. Classifications Compensation Survey
8. Central City Single Night Tax Rates and Tax Amount Comparisons
9. Five-Year Financial Plan Key Variable Sensitivity Analysis
10. Alternative Means for Financing Convention Center Expansion
11. Report on County of San Diego Outsourcing Program
12. IBA Per Capita Study and Peer City Benchmarking Comparison
13. Presentation on Municipal Bankruptcy Regulations
14. Under Utilized Asset Report, (prepared by EDC)
15. Bloomberg Financial Report on Municipal Bond Default
16. IBA report#09-88; 2010 First Quarter Budget Monitoring Report

Task Force Member Bios

Vincent Mudd, Chairman

Vince Mudd is president and owner of San Diego Office Interiors. He currently serves as chairman of San Diego Regional Chamber of Commerce's Public Policy Committee and as treasurer of the San Diego Regional Economic Development Corporation. He also served as member to the City of San Diego's Charter Review Committee and chaired the State Compensation Insurance Fund's Investment Committee.

Bill Roper, Vice-Chairman

Bill Roper is President of Roper Capital Company, a private investment firm based in La Jolla. Previously, he was President and CEO Of VeriSign, Inc, a NASDAQ 100 provider of internet security products and services. He was also Executive Vice President and CFO of SAIC, a Fortune 300 diversified technology services company.

Neil Derrough

Neil Derrough is the former President of NBC 7/39 in San Diego. Prior to his position at NBC 7/39, he was the President of the CBS Television Stations in New York City. He served as CEO of School Futures Research Foundation, a group of charter schools in San Diego and other parts of California.

Pete Garcia

Pete Garcia is the former President and CEO of University Mechanical & Engineering Contractors. He serves as Chairman of the San Diego Regional Economic Development Foundation, Chairman of the board of AVID Center, past Vice-Chair of the State of California Commission for Economic Development. He is a member of the Strategic Roundtable, and a member of SDSU Engineering advisory board. Pete Garcia specializes in turnarounds of troubled companies and/or projects.

Mark Koob

Mark Koob was an owner/partner and CEO of Bumble Bee Seafoods; purchasing the company from bankruptcy and then selling it to Con Agra foods after it had grown to sales of almost \$1.0Billion and EBITDA of about \$100MM. Mark started Quan Investments LLC, a private equity fund which makes both passive and controlling equity investments in packaged goods companies across the country.

Dan Shea

Dan Shea has spent the last 30 years focusing on corporate finance and management, working on a variety of turnarounds and ultimately selling a company he controlled to a multi-national, Illinois Tool Works. In 1995, with partners, he started Paradigm Investment Group which now owns 100+ restaurants nationally and employs 3000+ people. He is President/CEO of Donovan's Steak & Chop House, locally owned, with operations in San Diego, Phoenix and Salt Lake City.

Susan Snow

Susan Snow serves as Managing Director of Odyssey Capital Group. She has managed HR, IT, Finance, Operations, Sales & Marketing, and Contracting departments. She has served in a number of high-level Financial, Executive and Board level roles and is a member of numerous public and private corporate Boards.

Mark Stephens

Mark Stephens is the Office Managing partner for the San Diego Office of Ernst & Young LLP. As a certified public accountant and audit partner he provides financial reporting guidance for public and private entities and directs financial audits for a wide variety of businesses. He holds positions on numerous boards of community organizations.

Robert Tjosvold

Robert Tjosvold previously held a dual role of Commercial Market Executive and Market President of San Diego County with Bank of America for 38 years. He served on the boards of the San Diego Regional Economic Development Corporation, the San Diego Regional Chamber of Commerce, YMCA of San Diego County and the Old Globe Theatre. He is currently a board member of the San Diego Bowl Game Association and the Scripps Health System.

Richard Vortmann

Richard (Dick) Vortmann served as President and CEO of National Steel and Shipbuilding Company (NASSCO) and as Vice President of General Dynamics Corporation. He was Interim President and CEO of the San Diego Regional Chamber of Commerce. He is the Chairman of Scripps Health, Vice Chairman of the Dept. of Commerce Sea Grant Colleges Advisory Board, and a Member of Council, American Bureau of Shipping. He was a Trustee of the San Diego City Employees Retirement System, a member of the San Diego Mayor's Blue Ribbon Finance Committee, and Vice Chair of the San Diego Pension Reform Committee.

Barbara Warden

Barbara Warden is currently President of the Holiday Bowl. She was previously President of the Downtown San Diego Partnership, Regional Vice President for WINfirst, and Owner/Publisher of Bernardo News. She also served on the San Diego City Council, District 5.

Bob Nelson
3624 Robinson Mews, San Diego, Calif. 92103

January 2, 2010

Mr. Vince Mudd, Chair
Civic Leadership Team Citizens' Fiscal Sustainability Task Force
3706 Ruffin Road
San Diego, CA 92123-1812

Dear Vince:

Thank you for providing a copy of your group's *Report Highlighting Challenges & Opportunities*. Your organization has gathered an impressive pool of senior talent, and your work product reflects the intense effort you have undertaken to shed light on the City's financial outlook.

I encourage anyone who is truly interested in solving – not deferring – the City's financial woes to read your report. Based on your study and that of the City's Independent Budget Analyst, there seems little room to doubt that San Diego faces a structural -- not an occasional – budget deficit. As your report suggests, structural problems need structural solutions.

We have also obtained the 2005 *Bottom Line* Report from CPI cited in your report and distributed it to members of the Citizens Revenue Review and Economic Competitiveness Commission (CRRECC). While it has very interesting information, the data is somewhat stale. Its principal author, Dr. Baxamusa, advises me that he is obtaining more current revenue data from the Office of the State Controller; when that becomes available, we will forward it to you.

Several items in your report are especially illuminating and directly relevant to the mission of the CRRECC, as defined in the City Council's enabling Resolution.

Comments in your report particularly relevant to our Commission's mission include *"Recommended Course of Action, 9. The City should immediately implement a plan to promote business expansion and growth in the City of San Diego"* and the final two points in *"The City's Fiscal History,"* to wit:

- *"The City raises the least General Fund Revenues per household, measured as a percentage of household income, of any of the ten largest cities in California.*
- *The City provides some services selectively to certain residents with no cost recovery to the General Fund while charging other residents and businesses for the same service. Examples include: Residential Trash Collection - Storm Water Compliance."*

CRRECC will seek to quantify and validate information presented to us. To this end, we will be asking others for comments on your report, CPI's, and that of others as they come to our attention.

Meanwhile I have attached a few questions that occurred to me while reading your report; answers to and amplification on these topics could be very helpful. If it is convenient for you to forward copies of any underlying data or reports, that would be extremely useful, as well. I am also circulating this letter to my colleagues on the Commission and urging that they submit any additional questions to our Commission staff to collate and transmit to you.

I have read varied news reports about the Civic Leadership Team but I do not have a clear understanding of your overall mission and membership. How can CRRECC learn more about your organization, its members, meeting schedules, etc. so we can keep current with – and perhaps collaborate with – your broader organization from time to time?

Vince, on a personal note, thank you for all the efforts you put into improving our community. Your energy, intelligence, focus, and compassion are a rare combination, and San Diego is a better place for it.

Sincerely,

A handwritten signature in black ink that reads "Bob Nelson". The signature is written in a cursive, flowing style.

Bob Nelson
Chair, CRRECC

cc: Citizens Revenue Review and Economic Competitiveness Commissioners
Hon. Tony Young, Chair, City of San Diego Budget and Finance Committee
Hon. Kevin Faulconer, Member, City of San Diego Budget and Finance Committee
Hon. Todd Gloria, Member City of San Diego Budget and Finance Committee
Hon. Marti Emerald, Member, City of San Diego Budget and Finance Committee
Hon. Carl DeMaio, Member, City of San Diego Budget and Finance Committee
Andrea Tevlin, Independent Budget Analyst, City of San Diego
Wally Hill, Assistant Chief Operating Officer, City of San Diego
Paul Prather, Deputy City Attorney
Breanna Zwart, Commission Consultant

Questions from Bob Nelson for Vince Mudd, Chairman,
Citizen's Fiscal Sustainability Task Force of the Civic Leadership Team

- **Task Force Observations** "... even though the number of City employees seems in line with comparable cities, the City's unit cost of labor is extremely high."
 - What is the ratio of City of San Diego employees per capita compared to other cities in your data set? Which cities compose the comparison?
 - What is the unit cost of labor in San Diego and in the comparable data set?
 - What is the source data for the above information?
- Ibid, "... the forced toleration of underperforming employees is a serious morale problem, which over time impacts overall efficiency."
 - What is the source data for the factual statement and the conclusion?
- **Recommended Course of Action**, "1. The Mayor and Council must have the political will to declare a Fiscal State of Emergency..."
 - I am confident your group considered the potential impacts of such a Fiscal Emergency declaration on home and business values and marketing of the city as a vacation and convention destination, so such a Declaration presumably has specific beneficial consequences that would offset any detriments. Please explain the legal implications of such a Declaration under the City charter, ordinances, or policies or federal or state government statutes or regulations as it relates to the City of San Diego, if any, and the positive consequences of such implications.
- Ibid, "2. Immediately eliminate the current 800 vacant positions from the budget."
 - Has the Council's recent adoption of the revised FY 2010 and conceptual approval of the 2011 budget accomplished this recommendation? If not, to what extent does this remain incomplete?
- Ibid, "8 The City should adopt the concept of a "Poison Pill"⁴ to enforce a new fiscal management process... ⁴... plan would automatically include an across the board cut of services plus an automatic fee hike."
 - Please explain how the concept of an "automatic fee hike" could be accomplished given the limitations of voter-adopted provisions of the California constitution, as well as the City Charter and ordinances.
- Ibid, "9. The City should immediately implement a plan to promote business expansion and growth in the City of San Diego"
 - Please provide any reports, testimony or other information that you considered in reaching this conclusion to the extent such might enlighten or instruct CRRECC as we pursue our mission in this regard.
- Ibid, "10. The City should establish a fact-based dialogue with citizens..."

- This concept is inherent to CRRECC's scope of work. We will sincerely appreciate any thoughts you or your colleagues have on how we can best accomplish our part in this important activity.
- Ibid, "11. *If the City Council is unable to make the required structural cuts that will balance the FY2011 budget without accounting deferrals and gimmicks, a "Citizen's Initiative" should be placed on the ballot that forces a permanent reduction of City staff by at least 1,500 people...."*
 - Is this 1,500 FTE in addition to the previously recommended 800 positions? Based on the recently adopted "18 month budget" please summarize/clarify how many additional positions should now be cut through an initiative election if the Council and Mayor cannot or will not make the "structural cuts" to which you refer.
 - With respect to the FTE cuts you propose to mandate by voter initiative in the absence of prior government action to reduce spending, what departments of city government do you envision cutting, and to what extent will that impact service levels in these various departments?
- Ibid, "12. *Once permanent fiscal disciplines have been implemented and exhausted, the City should seek voter approval to create new fees and/or taxes to support delivery of the remaining services that the citizens deem to be essential core services; for example Storm Water Compliance and Trash Collection."*
 - What is the basis for the recommendation that all the "fiscal disciplines" must be "implemented and exhausted" before pursuing increased fees for storm water compliance and equal sharing among all residents for trash collection? Why can these not proceed on separate, but contemporaneous tracks? If the right thing to do is to raise these fees (which I am not presupposing) then why would we not do the right thing now while simultaneously seeking to cut expenses?
- **"Revenue Generating Suggestions..** *By listing the items, the task force is not specifically endorsing the revenue concept or expressing any preference. 1. The following potential revenue sources should be looked into: Transient Occupancy Tax (TOT); Storm Water Compliance fees; Real estate transfer tax; Business license fee; Refuse collection fee; Utility users' taxes; Parking meters; Fire protection zones."*
 - I will propose to my colleagues that we use your list as a starting point for our review of revenue possibilities. Please provide copies of any documents, studies, reports, testimony, etc. that might be useful to CRRECC in our consideration of these possible sources. We have limited staff resources and any way you can help us not "reinvent the wheel" would be much appreciated.

A REVIEW OF

“CITY OF SAN DIEGO’S FISCAL OUTLOOK: CITIZENS TASK FORCE REPORT HIGHLIGHTING CHALLENGES AND OPPORTUNITIES”

DECEMBER 11, 2009

CITIZEN’S FISCAL SUSTAINABILITY TASK FORCE

PREPARED BY

W. ERIK BRUVOLD

PRESIDENT

NATIONAL UNIVERSITY SYSTEM INSTITUTE FOR PUBLIC POLICY

It should be noted that the report’s principal objective was to identify ways to close the near-term gap between the forecasted costs of delivering municipal services to the citizens of San Diego and forecasted revenues. As the report’s assertion is that the unit-labor cost of providing mandated services in the City of San Diego is “unsustainable”, the authors largely focused on possible ways of reducing compensation and benefits in the City of San Diego. The effort of balancing expenditures and revenues is, while related, different from the four objectives of the commission:

- Receive findings of Revenue Audit conducted by the Independent Auditor and pursuant to those findings, make recommendations to the Mayor and Council for their review and consideration.
- Receive findings from a city-wide survey on optimum city service levels desired by the public, and make recommendations to the Mayor and Council for their review and consideration.
- Research strategies to retain existing businesses, attract new businesses, and develop businesses in San Diego and make recommendations to the Mayor and Council for their review and consideration.
- Research strategies to maximize revenues of the city which go towards the City’s core function of services including neighborhood infrastructure improvements, libraries, park and recreation, and public safety and make recommendations to the Mayor and Council for their review and consideration.

Thus this review only touches upon the empirical findings in the commission’s report that the author believes touch upon the four charges made to the commission and does not review the reports main research effort or findings.

1) GENERAL FUND DEFICIT (pages 1 and 3). The report notes the projected FY 2011 general fund deficit of \$179 million. Subsequent to the report's release, the Mayor proposed and the Council enacted a set of policies which closed the FY 2010 and FY 2011 budget deficits. On January 4th the San Diego Independent Budget Analyst released a report which forecast that the FY 2012 deficit is likely to be *at least* \$77 million and that their office, "anticipates the estimated deficit for FY 2012 will increase as updated information becomes available related to the City's major revenue sources, as well as possible changes to original cost savings associated with proposed service reductions."¹

2) COMPARATIVE GENERAL FUND REVENUES (Page 4). The Report argues that the City of San Diego, "raises the least General Fund Revenues per household, measured as a percentage of household income, of any of the ten largest cities in California." While no citation is provide, we believe this is largely derived from the conclusions made by the Center for Policy Initiatives' "The Bottom Line".² In our review of CPI's work we have not found any mathematical errors but do believe that citizens may be as likely to think about their ENTIRE tax burden as measured as a percentage of household income as opposed to the disaggregated parts. On that measure, San Diego is decidedly "in the middle".³ It also does not account for the peculiar nature of how California distributes property tax receipts, with some jurisdictions receiving a much higher percentage than others even though the tax rate and method of calculating assessed value does not vary.⁴ For example, if San Diego received the same percentage of property tax receipts as the City of Los Angeles, in 2010 it would have received approximately \$100 million more in General Fund Revenue. *That would still leave San Diego with among the bottom third using CPI's measure* but this does point out the role that the unequal distribution of property tax receipts plays in determining per capita general fund spending among California municipalities.

3) CHARTER MANDATED SERVICES (Page 6). The Report reads "State law and the City Charter delineate those services that the City must provide (i.e. police department, fire department, water utility, public works services, water services, building inspection

¹ . "Developing a Structural Budget Deficit Elimination Plan", San Diego Independent Budget Analyst Report, 10-01; January 4, 2010.

² . Murtaza H. Baxamusa; "The Bottom Line"; Center for Policy Initiatives (April 2005); pg. 6

³ . See, for example, Dean Stansel "Higher Taxes, Less growth: The Impact of Tax Burden on Economic Growth within U.S. Metropolitan Areas"; National Foundation for American Policy (2009) <http://www.nfap.com/pdf/0904taxesmetro.pdf> (accessed January 5, 2010) and "Comparing State and Local Taxes in Large U.S. Cities" New York City's Independent Budget Office (2007) <http://www.ibo.nyc.ny.us/iboreports/CSALTFINAL.pdf> (accessed January 5, 2010).

⁴ . For example, in 2007-2008 municipalities in San Diego County received 11 cents of every dollar of property tax collected. In contrast, municipalities in Alameda County (19 cents); Los Angeles County (15 cents); and Fresno County (12 cents) receive a higher percentage of property taxes. The combined City and County of San Francisco receive a whopping 61 cents of every dollar (the combined figure for the cities and counties of San Diego is 25 cents). These differences result in varying support from property tax receipts for local schools districts in California which, in turn, creates variation in the level of state aid they receive. These differences are the result of legislative efforts, in the aftermath of the passage of Proposition 13, to cushion the blow to local government and school budgets. See State Board Of Equalization Annual Report, 2007-2008, table 15; page A-19.

services, public health services, park and recreation services, library services and other services as maybe (sic) desired and authorized by the Council by ordinance.”). The commission should understand this is a cursory summary of the services required under the charter, municipal code, and council policies. In preparing to “receive findings of a City Wide Survey on optimal service levels” it may behoove the Commission, the City, and the organization charged with conducting the survey to have a reasonably deep understanding of what specific services are mandated (and thus in the short term largely “off the table” when it comes to services reductions in the short term) and which are more discretionary. Put another way, does it make much sense to ask citizens about how much they value a particular service if, prior to its elimination, it would require a city-wide election and/or state legislative changes?

4) TAXES AND RELOCATION (Page 7) The report argues. “[San Diego’s] tax and fee policy should not be so high as to drive businesses or citizens out of the City of San Diego.” The current state of economic research on this point suggests that “business climate” and tax exposure is only one of a myriad of factors that influence business location decisions and may not be the most important.⁵ In one notable study that examined longitudinal data from the Dunn and Bradstreet databases, Jed Kolko and David Neumark of the Public Policy Institute of California found little evidence that even with California’s relatively high rates of taxation and more restrictive regulatory environment there was widespread migration of businesses from California to surrounding states.⁶ The commission would be, in my opinion, wise to understand the general unsettled nature of this question in the literature on urban economics. While marginal municipal tax rates could undoubtedly rise to such levels as to drive businesses out (especially if not used to increase those services that firms value), it is far from clear that the City of San Diego is anywhere near that point in respect to the principal revenues it currently relies upon, the potential new sources (see for example the list on page 14 of the report) of revenue, or in comparison to other nearby California or even Western jurisdictions.

5) ECONOMIC DEVELOPMENT AND MUNICIPAL REVENUES (Page 9). The report asserts that “we compete with other cities for expansion” and “the continued loss of business-related revenue will deal a blow to the City’s economic prospects”. This mischaracterizes the nature of San Diego (and indeed California’s) way of financing municipal services. San Diego and other California cities only indirectly tax business-related revenues. Instead, San Diego and all other cities in California largely tax *consumption* through the use of the sales and use tax, transient occupancy tax, and ad valorem property taxes. What that distinction means in respect to public policy is critical. At the most extreme, it can mean that a business which consumes and produces largely non-taxable services, occupies an older structure subject to property taxes capped by California Proposition 13, and whose employees largely live outside of the community

⁵ . One recent review of relevant research and findings can be found in Yoonsoo Lee, “Geographic redistribution of US manufacturing and the role of state development policy”, Journal of Urban Economics; (vol.64, no 2, 2008).

⁶ . Most notably see Jed Kolko and David Neumark, Business Location Decisions and Employment Dynamics in California, Public Policy Institute of California; 2007

(and thus consume goods in those locations) can be a significant net fiscal drain on a city even if the business pays extremely high wages and would otherwise be considered a wonderful economic development asset. This paradoxical fiscal situation helps also explain, for example, why the population of National City can have one of the region's lowest household income levels but have extremely high per-capita revenues, why San Diego's revenues have fallen so far, so fast even while San Diego's leading technology sectors have survived the recession reasonably well, and why California jurisdictions so fiercely compete to attract retailers even though the wages which they pay are comparatively low. The commission, in my opinion, would be wise to keep this paradox this in mind as it seeks to think about the relationships between its third and fourth objectives.

January 11, 2010

Re: "City of San Diego's Fiscal Outlook: Citizens Task Force Report Highlighting Challenges and Opportunities"

Dear Chairman Nelson:

Thank you for the opportunity to review the information provided to the commission and to offer our feedback. Per your request, we have read the final report from the Citizens Task Force, your letter to the chairman of the Task Force, the IBA "structural deficit" update, and Erik Bruvold's comments. All of these documents are extremely thoughtful and, we're sure, will prove to be of tremendous value to the Commission.

While we agree with a great deal of the comments made by the Task Force and Mr. Bruvold, we would like to offer several additional responses:

1. Additional Sources of Information

In your letter to Chairman Mudd, you requested guidance on "any documents, studies, reports, testimony, etc. that might be useful to the CRRECC in our consideration" as to reduce the amount of time spent by the commission on "reinventing the wheel." In addition to the documents cited by the Task Force and Mr. Bruvold, we recommend that the commission closely review the "City of San Diego Facilities Financing Study" prepared by Kelling, Northcross & Nobriga for the Strategic Framework Citizen Committee in 2002 (included as an attachment to this letter). While dated, this report carefully compares various San Diego General Fund revenues to a set of in-state and out-of-state "peer" cities, and outlines the legal procedures for raising specific revenue sources. At the very least, the document provides a useful template for approaching comparative fiscal analyses.

2. City Comparisons

Both Mr. Bruvold and the Task Force offer statements regarding San Diego's revenue receipts relative to other cities (specifically, in the context of "The Bottom Line" report). While such comparisons are vital to the Commission's work, it is important that the commissioners recognize that the conclusions such analyses produce are highly dependent on the choice of "peer" cities included in the analysis. For example, when comparing General Fund revenues, the commission should probably exclude San Francisco, which, as a city-county, has access to revenues unavailable to the City of San Diego and is also obligated to provide services that San Diego is not. (San Francisco is one of the comparative cases included in "The Bottom Line" report.) Great work and care should be invested in *defining the criteria* that will be used to select candidate cities for comparison.

3. Taxes and Relocation

We wholeheartedly echo Mr. Bruvold's comments regarding the influence of local fiscal policy on business location decisions. Researchers generally conclude that a variety of factors — including, but not limited to, costs, local labor force characteristics, and the presence industry “clusters” — determine where businesses choose to set up shop. There is little consensus on the relative importance of these factors and it is far from clear that “business climate” and tax burdens are the most important factors in location decisions. In particular, we urge the commission to recognize that:

- Decisions to improve one aspect of the local “business climate” may have unintended effects on other important business considerations. For example, reducing city taxes and fees to attract new businesses may have the opposite effect if doing so reduces the quality of city services and thus causes highly skilled workers to leave the city.¹
- There is tremendous heterogeneity among the city's business establishments, which results in large variation in how city policies influence local economic development. While high taxes may encourage flight among “mobile” businesses, they are unlikely to do so for businesses with high sunk costs or whose livelihood is dependent on remaining in San Diego (e.g. tourism-related and military industries).

4. Tax Incidence

The Task Force's discussion of business flight appears to assume that fees and taxes collected from businesses are also “incident” upon them. (A tax is generally said to be “incident” on those who must bear its burden.) In practice, there is often a great divergence between the identity of those *from whom taxes are collected* and the identity of those *who actually pay them*.² For example, businesses often pass on higher costs to employees (in the form of reduced compensation) and on consumers (in the form of higher prices). The extent to which city fiscal policy affects the local “business climate” is an open empirical question and depends on (1) the extent to which local taxes and fees are incident on business owners, rather than their employees and customers; and (2) the extent to which local government revenues collected from taxes and fees on businesses are invested in public goods and services that enhance the local business environment.³

5. Costs of Economic Development

While the Task Force has urged the city to implement a plan to “promote business expansion,” it is important to recognize that such efforts often entail substantial tradeoffs. For example, policies designed to attract new businesses by providing tax concessions or

¹ See, e.g., Richard Florida, *The Flight of the Creative Class: The New Global Competition for Talent*, HarperBusiness Press, 2005.

² See, e.g., Don Fullerton and Gilbert E. Metcalf, “Tax Incidence,” in *Handbook of Public Economics, Volume 4*, edited by A.J. Aurbach and M. Feldstien, Elsevier Science B.V., 2002.

³ See, e.g. Alberto Alesina and Dani Rodrik, “Distributive Politics and Economic Growth, *Quarterly Journal of Economics* Vol. 109: 465-490, 1994. (Notes that a tax on capital can increase economic growth when its proceeds are invested allocated productively.)

economic incentives usually produce significant impacts on the public treasury, in the form of additional expenditures or forgone tax revenues and expenditures. Put another way, efforts to promote business expansion often entail costs and sacrifices for city residents. Because those who must pay these costs are often not the same individuals who benefit from economic development policies, choosing to promote business expansion can result in important distributional consequences. As a result, economic development policies sometimes take the form of transfers from the least to the most well off, an outcome that is both normatively problematic and in conflict with fundamental economic theory.⁴ Policy makers should be aware of these distributional consequences, and the potential costs of economic development policies, and carefully weigh these against any benefits that such policies will create.

6. Managed Competition and Outsourcing

The Task Force has suggested that implementing Managed Competition and privatizing city services is necessary to close the city's structural deficit. While this question is not of primary interest to the Commission, it is important to recognize that it is closely tied to the objectives outlined in the Commission's charter in that reducing city costs also reduces the need for new city revenues. We urge the Commission to exercise caution in accepting the Task Force's claim that outsourcing city services will result in significant cost savings that reduce the need for additional city revenues. While some researchers have documented the potential for significant cost savings,⁵ it is important to note that these conclusions are based on carefully selected case studies that may not necessarily be representative of general municipal experience with outsourcing.⁶ Potential for savings from outsourcing service delivery appears to depend on the type of providers chosen (non-profit vs. for-profit) and the nature of the city services contracted out.

7. Efficiency vs. Competing Values

The Task Force report appears to assume that maximizing *efficiency* in service delivery is the primary objective of the city and the sole criteria for evaluating policy options. Such an assumption, however, ignores other vital values that are at the heart of democratic governance. Residents and voters have expectations not only about (1) policy *outcomes* (these values include *efficiency*, in addition to *equity* and *fairness*) but also about (2) policy *processes* (these values include *transparency*, *public consultation*, and concern for *due process*). All of these values are incorporated, to various degrees, into the state and federal constitutions and laws, and the city charter. It is important to recognize that

⁴ See, e.g., Frank P. Ramsey, "A Contribution to the Theory of Taxation," *Economic Journal* Vol. 77: 47-61, 1927.

⁵ Geoffrey F. Segal, Adam B. Summers, Leonard C. Gilroy, and W. Erik Bruvold, "Streamlining San Diego: Achieving Taxpayer Savings and Government Reforms Through Managed Competition," San Diego Institute for Policy Research and Reason Foundation.

⁶ See, e.g., Hee-Soun Jang and Richard Feiock, "Fiscal Implications of Contracting Out Local Services: A Heckman Selection Model Approach," Paper presented at the New Public Management Research Association Meeting, Washington, D.C., Oct. 9-10, 2003. (Notes that "[R]esearch on local governance choice did not always hold that contracting out choices had positive impact on reducing municipal expenditure," page 28.)

maximizing certain values, for example transparency and due process, may entail necessary tradeoffs in other values, for example efficiency. While the Task Force notes that the city's Civil Service rules appear to reduce the city's operating efficiency, this reduction allows the city to achieve policy objectives tied to other important democratic values that its constituents hold dear. At minimum, policymakers should be transparent and honest about how specific policy proposals may entail tradeoffs among competing values and evaluation criteria.

8. Structural Deficit

The Task Force appears to assume that the city's projected General Fund deficit is the result of a "structural deficit." While there is no doubt that San Diego has a sizeable structural deficit, as ably documented by the IBA, we have seen little credible effort to apportion the projected operating deficit into its "structural" and "contingent" (e.g. revenue shortfalls caused by global economic crisis) components. Using one-time revenues and reserves to address nonstructural deficits is entirely permissible — indeed, such deficits are the reason why reserves exist. We believe the Commission could make a tremendous contribution to the city's civic dialogue by identifying and quantifying the structural and contingent components of the city's projected deficits. (Efforts by the Pension Reform Committee to similarly breakdown the city's pension deficit into its constituent parts proved to be an invaluable service to policymakers and the community.)

We hope that these comments will be helpful to the Commission's deliberations and look forward to providing additional assistance.

Sincerely,

Steven P. Erie
Vladimir Kogan
Scott A. MacKenzie

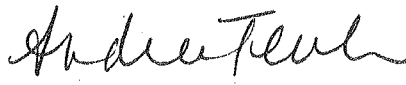
Parking Lot for January 7, 2010

- Top 10 Revenue Generating Businesses in San Diego
 - BZ sent an email to Julie Dubick to include in presentation
- City of San Jose update
 - The IBA will provide a memo
- City Services Survey
 - Ad-Hoc Committee on Survey, Dr. Singh will work with the IBA
 - Update from the IBA on 1/28
- Alternative revenues
 - IBA will present on this topic 3/11
- User Fees
 - IBA is working on a list of restrictions with existing fees
- Property Tax
 - IBA is working on a report
- Best practices in job creation
 - BZ asked Dr. Gin to present on this topic
- Past reports on TOT/ Arts and Culture
 - IBA

**OFFICE OF INDEPENDENT BUDGET ANALYST
CITY OF SAN DIEGO
M E M O R A N D U M**

DATE: January 20, 2010

TO: Citizens Revenue Review and Economic Competitiveness Commission

FROM: Andrea Tevlin, Independent Budget Analyst 

SUBJECT: Update on City of San Jose Budget Deficit Elimination Plan

In February 2008, the IBA issued report no. 08-14 on "City of San Diego Structural Budget Deficit", which described the City's persistent structural budget imbalance. The report provided a general overview of the approach that could be taken to overcome a structural budget deficit, and described the process of the City of San Jose, which had already begun to take necessary steps to combat a similar problem.

This same report, with some updates, was presented at the first meeting of the Citizens Revenue Review and Economic Competitiveness Commission on December 15, 2009. Following the presentation, Committee members inquired as to the level of success experienced by City of San Jose in implementing its plan.

On January 4, 2010, the IBA issued report No. 10-01 entitled "Developing a Structural Budget Deficit Elimination Plan". This report included an attachment (#3) which described the work by the City of San Jose in its ongoing efforts, including updated information since 2008. This information is provided as an attachment to this memorandum to respond to the earlier request of the Committee.

As a result of the plan, the City of San Jose successfully passed two ballot measures in November 2008, which provided \$20 million in budgetary relief. Since that time, the effects of the recession have exacerbated the budget deficit. However, they continue to update and review the revenue and expenditure projections, in a five-year forecast context, on a regular basis, and they continue to pursue hundreds of options that have been identified and prioritized. At a recent Council meeting in November 2009, the City Manager proposed a thorough prioritization of City services in order to prepare for drastic service reductions.

My office will continue to monitor the progress of the City of San Jose and provide interim updates as new information becomes available.

Attachment: IBA Report No. 10-01 (Attachment 3) –
Status of City of San Jose Structural Budget Deficit Elimination Plan

City of San Jose Structural Deficit Elimination Plan

In November 2008, the City of San Jose released the General Fund Structural Deficit Elimination Plan, which outlined specific strategies and timelines to eliminate the structural budget deficit over a three year period. The plan described a total cumulative structural deficit of \$106 million for the next five years. In finalizing the plan, it was recommended that the three year timeframe to eliminate the deficit be extended to five years, ending in Fiscal Year 2014.

A series of thirteen Budget Principles were recommended for adoption to help prevent the City from again developing a structural budget deficit.

City of San Jose Budget Principles:

1. The General Fund Budget shall be structurally balanced in each year of the five-year budget projection;
2. General Fund proposed budget balancing plan shall be presented in the context of the five-year forecast;
3. One-time resources shall not be used for current or new ongoing operating expenses;
4. New unbudgeted requests during the year shall be considered in light of the unfunded programs list and include an offset to have a net-zero effect on budget;
5. All City funds shall maintain an adequate reserve level – 3% for General Fund;
6. The City shall not issue long-term General Fund debt to support ongoing costs unless it achieves net operating cost savings;
7. Negotiations for employee compensation shall focus on cost of total compensation while considering the City's fiscal condition, revenue growth, and changes in the CPI;
8. Capital Improvement Projects shall not proceed for projects with annual operating and maintenance costs exceeding \$100,000 in the General Fund without City Council certification that funding will be made available in applicable year.
9. Fee increases shall be utilized, where possible, to assure that fee program operating costs are fully covered by fee revenue and explore opportunities to establish new fees for service where appropriate;
10. City staff shall seek out, apply for, and effectively administer federal, State and other grants that address the City's priorities and policy objectives;
11. The General Plan shall be used as primary long-term fiscal planning tool;
12. All requests for departmental funding shall include performance measurement data so that requests can be reviewed in light of service level outcomes to the community and organization;
13. The inclusion of the closure, sale or relocation of a fire station as part of the City budget is prohibited without prior assessment, community outreach, and City Council approval on the matter.

An update to the plan was issued in February 2009, including revised revenue and expenditure projections, and an increased cumulative structural deficit of \$116 million was reported at that time. The greatest annual amount of \$67 million was expected in Fiscal Year 2010. The update acknowledges that the deep global recession resulted in downward revisions to revenue estimates for existing sources, as well as for the estimates for revenue strategies, since the original plan. The February 2009 update indicates that no strategies have been eliminated from consideration since the original plan. The identified strategies now ranged in total value from \$154 million to \$184 million, for the five-year period.

The City of San Jose's Fiscal Year 2009 Adopted Budget also included Budget Balancing Strategy Guidelines that were approved by the Council. The strategies outlined in the deficit elimination plan are a model to achieve a balanced budget within five years, with every strategy linked to a Budget Principle and in alignment with the Budget Guidelines.

City of San Jose Budget Balancing Strategy Guidelines:

1. Develop a budget that balances the City's delivery of essential services to the community, including building strong neighborhoods and supporting economic growth, with the resources available;
2. Resolve the projected budget deficit with ongoing revenue and expenditures solutions to ensure no negative impact on future budgets;
3. Use fee increases, where possible, to assure that operating costs are fully covered by fee revenue and explore opportunities to establish new fees for services where appropriate;
4. Explore expanding and/or re-directing existing revenue sources and/or adding new revenue sources for addressing both the structural deficit and unfunded needs, such as infrastructure maintenance backlog or the unfunded liability associated with post-employment health benefits;
5. Focus on protecting core City services for both the short- and long-term. Analyze all existing services and target service reductions or eliminations in those areas that are least essential;
6. Defer any new program commitments and initiations or program expansions, unless these commitments stimulate the local economy, job creation, generate new revenues and/or are funded through redeployment of existing resources;
7. Consider alternative service delivery mechanisms to ensure no service overlap, reduce and/or share costs, and use our resources more efficiently and effectively;
8. Focus on improving employee productivity and business practices, including streamlining, innovating, and simplifying City operations;
9. Use the General Plan as a primary long-term fiscal planning tool and link ability to provide City services to development policy decisions;
10. Continue to make community and employee involvement a priority for budget balancing idea development;
11. Make every effort to eliminate positions, rather than filled positions, to limit the number of employee layoffs;
12. Explore personnel services cost savings, subject to the meet and confer process by 1) considering further incorporation of total compensation bargaining concepts and focusing on all personnel services cost changes (e.g., salary step increases, benefit cost increases), 2) civilianizing more sworn positions, 3) exploring alternative benefit structures for new employees, and 4) changing employee/retiree health care benefit plan designs.

The City Manager's General Fund Structural Deficit Task Force worked with a consulting firm to solicit input and feedback on potential strategies to address the structural deficit, through focus groups with a wide variety of stakeholders including community and business groups, City boards and commissions, City employees, labor unions and City management. They also conducted employee and community surveys and performed benchmarking against "best practice" cities including Phoenix, Austin, Long Beach, Minneapolis, Virginia Beach, Fairfax County- all of whom have been recognized for their long term sound financial practices.

Over 320 suggested strategies were identified and screened against qualification/disqualification criteria. The screening process resulted in 194 of the suggested strategies qualifying for further analysis. Of those that did not move forward, many could not be realistically implemented within the three year timeframe.

Eleven of the strategies were identified as "Urgent" that needed immediate attention in order to meet timeframes for ballot measures or other requirements. Ultimately, two ballot measures (out of five considered) were placed on the November 2008 ballot and were passed by voters related to the telecommunications users tax and the 9-1-1 fee. These measures reduced the structural budget deficit by \$20 million.

City of San Jose Qualification Criteria:

1. Preliminary benchmarking information shows that San Jose is below market (revenues) or above market (expenditures);
2. Strategy is being used in a best practice jurisdiction or a peer jurisdiction;
3. Prior work by budget office or other City department has made a convincing argument for change;
4. Practice is out of alignment with current City objectives or planning

City of San Jose Disqualification Criteria:

1. Strategy cannot be effectively implemented in three-year timeframe;
2. Strategy would not reduce deficit or if it does would have greater longer run costs;
3. Strategy is not consistent with current Council three-year goals;
4. Strategy would have a limited impact, and cannot logically be combined with other similar strategies.

The top twenty-one strategies to eliminate the deficit were assigned to three discrete categories:

1. Cost Savings Strategies
2. Revenue Strategies
3. Service Reductions /Eliminations

On November 5, 2009, the City of San Jose held a City Council budget planning session for the Fiscal Year 2011 budget. The FY 2011 budget deficit for the City of San Jose is now estimated at \$96 million, up from earlier estimates of \$36 million, with the increase primarily due to expected increases for pension payment requirements. The three major strategies under consideration are to reduce per employee costs; reduce/eliminate services; and, increased/new revenue.

Because of the implementation time frame required for many of the strategies under study in the earlier plan, the City of San Jose is recommending a thorough prioritization of City services at the program level to aid in its service reduction/elimination decision making process, which comprises the largest component of the structural budget deficit elimination plan. The prioritization process will include input from the community and stakeholders, City staff, management, and elected officials.



THE CITY OF SAN DIEGO
CITIZENS REVENUE REVIEW AND ECONOMIC COMPETITIVENESS COMMISSION

MEMORANDUM

DATE: January 20, 2010
TO: CRRECC Commissioners and Ex Officio Members
FROM: Bob Nelson, Chair *Bob Nelson*
SUBJECT: Status Report

Subject Matter Leadership: Thanks to those Commissioners who have volunteered to undertake leadership for the Commission on various topics. As of today, these include:

Commissioner Barros	Vice Chair; Revenue Review
Commissioner Bonano	Parliamentarian
Commissioners Morton and Nelson	Economic Competitiveness
Commissioner Singh	Public Opinion & Public Input
Commissioner Standifird	Independent Auditor's Report

Planning Meetings: We face many topics with limited time. We plan to keep meetings at about two hours. There will usually be informational briefings by staff or third parties. In each session, we also hope to have at least 30 minutes for Commissioners to discuss a defined topic. The independent audit and opinion research will have specific attention during a few meetings. Generally, I hope to achieve approximately equal time over the course of our meetings to discuss revenue and competition. In addition, to use our time in meetings wisely, we plan to limit most presentations to 15 minutes and limit Commission discussion on each topic in accordance with the two-hour rule. Additionally, we will deal with housekeeping/administrative matters in written memoranda, rather than use time during meetings. If you have other thoughts about how we should plan for future meetings, please express these at your convenience.

Staff Support: In addition to the excellent work being done by Consultant Breanna Zwart, we have received some additional support. Councilmember Gloria has arranged for an intern, Lisa Maier, to work with us part days on Wednesdays and Thursdays and to attend our Commission meetings. Lisa will help us create a running history of our progress and documenting our consideration of various inputs. She will also be performing various administrative tasks. If Commissioners require staff support, please contact either Breanna or me to help arrange it for you.

Pending Meetings with Councilmembers: During the next few weeks, I will meet with individual Councilmembers to update them on our status and seek input on possible revenue sources and ideas for improving economic competitiveness. I will prepare a memo for the Commission on ideas gathered during these sessions.